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SUBJECT: MALAWI: THE CASE FOR MCA COMPACT ELIGIBILITY

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11. (SBU) Summary: Over the past two years, Malawi has embarked on a process of positive reform, led by the government of President Mutharika, that has effectively reversed many years of corruption and misrule. The GOM has decisively taken control of its own development agenda, and has embraced the MCA Threshold Program, which complements a broader reform process taking place in the country. Malawi's goals are very well aligned with the objectives of the Millennium Challenge, and we believe the time is right for Malawi to be considered for MCA Compact eligibility. End summary.

MCA and Malawi: Made for Each Other

12. (U) When President Mutharika took office in May 2004, he announced two priorities: fighting corruption and fixing the country's economy. The president argued that unless Malawi could curb its rampant corruption, precious public resources would continue to disappear and investors and donors would shun the country. He further reasoned that the way to reduce Malawi's grinding poverty is to grow the country's economy, and not depend on handouts from donors. He exhorted Malawians to work harder to build "a producing and exporting country."

13. (U) Mutharika focused his efforts on improving the macroeconomic environment by reining in government spending, reducing borrowing, and inviting the IMF to monitor the GOM's finances. At the same time, the president took firm control of the country's development agenda. He launched a home-grown national development plan, the Malawi Growth and Development Strategy, to replace the donor-designed Poverty Reduction Strategy Paper. The new plan emphasizes economic growth and improvement of investment conditions, so that Malawi can grow its way out of poverty and begin to pay for its own social services. Mutharika also insisted that the new government deliver results. For the first time ever, cabinet ministers were compelled to produce monthly results reports, and he personally chastised ministers who failed to deliver. He fired poor-performing senior civil servants, and shifted others to new positions to inject new energy into their work. He ordered the consolidation of most government ministries to offices in the capital Lilongwe from locations in the provincial cities of Zomba and Blantyre, saving money and improving efficiency.

14. (U) The MCC Board recognized the changes taking place in Malawi,

and in November 2004 invited the country to apply for Threshold assistance. The Threshold program was an appropriate first step for Malawi, given the brief track record of Mutharika's government at that time, and the tendency of the previous Muluzi administration to backslide on reforms. As reported in reftel, the Threshold program has seen several early successes and has complemented well the other reforms that are going on in Malawi.

Strong Performance in All Three MCA Indicator Areas

15. (U) Malawi has demonstrated impressive performance in all three of the key MCA indicator areas of ruling justly, investing in people, and promoting economic freedom. Although Malawi slipped very slightly on the FY-2007 MCA corruption indicator (from .02 above the median to .03 below), the data do not tell the whole story.

16. (U) President Mutharika has made his "zero tolerance" anti-corruption campaign the centerpiece of his administration, and the GOM has scored important successes. The effort, supported by the Threshold plan and other donors, is aimed at punishing acts of past corruption as well as improving governance and strengthening institutions and the rule of law in order to prevent future corruption. Several senior officials (a cabinet minister, the mayor of the largest city, and senior civil servants) have been convicted of corruption, and many other cases are in process. As reported reftel, a range of regulatory and administrative reform efforts are underway to improve accountability, transparency and efficiency in government. For the first time in Malawi's post-independence history, the National Assembly is playing an active and much more assertive role in its oversight of the executive branch, conducting regular committee hearings and making policy recommendations.

17. (U) Furthermore, the lag of the corruption indicator data does not fully reflect these developments. The FY-2007 indicator is based on 2005 data, which were collected from a number of studies

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conducted in 2004 and perhaps earlier. The new government took office and began its reforms in mid-2004, and its efforts are very likely not documented in the data upon which the indicator is based.

18. (U) Malawi has shown remarkable leadership in health care, particularly in HIV/AIDS and malaria. The WHO recently commended Malawi for its highly successful scale-up of anti-retroviral therapy, one of the best in Africa. Malawi's distribution program of insecticide treated bednets is considered to be the worldwide best-practice model for other countries to follow. The country's inoculation rates are very solid, and Malawi has recently made significant gains in infant and maternal mortality.

19. (U) Without doubt, Malawi's greatest transformation in the past two years has taken place in the economy, with a performance that has earned glowing praise from the IMF and international donors. As with corruption, the scorecard data lag and do not give the whole picture. Under the guidance of the highly capable finance minister, Goodall Gondwe, the new government from the outset restrained spending and placed itself under the watchful eye of an IMF Staff Monitored Program. Following a year of good performance under the SMP, Malawi successfully qualified for a new IMF Poverty Reduction Growth Facility in August 2005, along with new budget support from bilateral donors. Continued strong performance over the past year brought Malawi to HIPC Completion Point in August 2006, with full debt relief under the Multilateral Debt Relief Initiative. The GOM's increased accountability, control of spending, and debt relief have all contributed to an optimistic outlook for the country's macroeconomic picture. Inflation has recently fallen from over 16 percent to approximately 12 percent, and is projected to fall to 10 percent by the end of 2006. Malawi's projected fiscal deficit for the 2006-07 budget is 2 percent of GDP. Domestic interest rates are also projected to decline, as the GOM's fiscal restraint and reduced borrowing lessens the pressure on local credit markets and frees up more capital for private sector investment.

¶10. (U) In response to Malawi's poor performance in the most recent World Bank "Doing Business" survey (and the related MCA indicator), the GOM has recently convened a task force led by the Minister of Trade to correct a number of deficiencies. The task force is focused on five areas-- licenses, taxes, trade across borders, access to credit, and closing a business-- and has prioritized "stroke of the pen" regulatory changes that can be quickly implemented. For example, opening a small business currently requires multiple licenses that are very costly. Depending on the nature of the enterprise, a businessperson might need four or five licenses that cost more than a year's wages for the average Malawian. The task force is proposing to collapse those licenses to a single permit and to slash the fees to a reasonable level. The task force also wants to equalize the fees paid by Malawians and foreigners, cut the top marginal company tax rate, and streamline the tax payment system. This reform effort is just starting, but if the GOM follows its own action plan, it should begin to improve its "Doing Business" rating within a year or two.

Bumps in the Road

¶11. (U) Despite the positive reforms and good performance of the past two years, there have been notable problems, particularly with political stability and governance. Mutharika's strong stand against corruption precipitated his resignation from his own party in early 2005, after which he formed a new party that became the ruling minority. His former party colleagues retaliated with an attempted impeachment, and the president further roiled the opposition by pursuing minor criminal cases against outspoken opposition MPs. The opposition eventually dropped its impeachment drive, but the contentious atmosphere in Parliament remains, most recently demonstrated by the June-August session that took over twice as long as planned to approve the national budget. This nasty "tit-for-tat" political infighting has diverted leaders' energy and attention from the urgent business of reform and development, and has diminished ordinary Malawians' confidence in their political leaders to work together in the best interests of the country. Mutharika has also moved slowly in making appointments to key positions; the country's two top prosecutorial jobs are currently unfilled, and there are many vacant positions on boards and commissions that perform important oversight functions for government and parastatal operations.

¶12. (U) Also of concern is the GOM's continued attachment to statist

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economic policies. Malawi has one of the highest levels in Africa of government intervention in the economy, a legacy of the Banda dictatorship that exerted strong control in virtually every economic sector. The GOM clings to inefficient and unprofitable state-owned enterprises, both for political reasons and because many senior leaders still believe that government should control at least some of the commanding heights of the economy. This is particularly true of Malawi's all-important agricultural sector, where again this year, the GOM will buy and distribute almost all of the country's requirement of fertilizer, because they don't trust the private sector to supply this "strategic" commodity. The GOM began a serious privatization program in 1997, and by 2004 approximately 55 of 110 state enterprises slated for privatization had been sold off. Mutharika stated his intention to continue the effort, but in his two years in office, only one privatization-- the national telephone company-- has been carried out. These economic white elephants continue to drain the treasury and place a drag on the overall efficiency of the economy.

Making it Stick

¶13. (U) The above problems notwithstanding, President Mutharika has decisively embarked on a strong path of reform, and he has no intention of turning back. Mutharika's reforms are by no means irreversible, but several factors give cause for optimism that the positive trends will continue. The Malawian public is hungry for change, and strongly supports the reform efforts. Malawians were greatly dissatisfied with the corruption and misrule of former

president Muluzi, and his ten years in power are commonly referred to as "the lost decade." The people of Malawi suffered for 30 years under the dictatorship of Hastings Kamuzu Banda, and many feel that Muluzi's maladministration robbed them of an important opportunity to move ahead and prosper.

¶14. (U) Malawians are conservative by nature, and many wish to restore the basic values of honesty and hard work for which their country was known throughout the region, particularly during the earlier years of Dr. Banda's rule. Many Malawians take pride in the reputation that Malawi enjoyed during the 1960s and '70s for having relatively low levels of corruption and good accountability for international aid funding. Mutharika has successfully tapped this longing for a return to a perceived former glory, and has enjoyed strong public backing for cleaning up the affairs of the country.

Great Potential, With Help from MCA

¶15. (SBU) Malawi is a country with great potential. The country has fertile soil, adequate water resources, an enormous labor pool, and a wealth of farming expertise; hence, its best prospects lie in the development of agribusiness. Unlike many of its neighbors, Malawi has no history of ethnic or tribal violence. The factors that are holding Malawi back at this time are incomplete policy reforms, inefficient transportation links to the global market, and weak infrastructure. An MCA Compact could be the key to removing those constraints and helping to push the country into a new era of economic growth and prosperity. The process of developing the Compact proposal would also help keep the country's leaders focused on the development agenda, particularly in the coming two years as the next general election of 2009 approaches.

¶16. (SBU) Malawi's reforms since 2004 have embodied all of the tenets of the MCA philosophy: economic growth, policy reform, and an emphasis on results, in a process developed and led by Malawians. The country possesses solid fundamentals that place it in an excellent position to take advantage of the "shot in the arm" that MCA Compact assistance would provide. For this reason, we believe that Malawi is an excellent fit for MCA, and we advocate Compact eligibility at the earliest opportunity.

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